



MEMORANDUM

TO: James P. Hallan
Eric Rule
Michigan Retailers Association

FROM: William J. Perrone

RE: Main Street Fairness Bills (HB 5004 and 5005)
Application to Internet "Click Through" Services

DATE: October 18, 2011

A question was recently raised in the House Tax Policy Committee regarding the application of the "contract affiliate" language of HB 5004 and 5005 to internet links through Google and other internet websites. You have asked for clarification as to how such language would work under the bills for purposes of requiring out-of-state sellers of personal property or services to Michigan residents to collect and remit sales or use taxes in Michigan.

In its current form, the bills provide a "presumption" that an out-of-state seller is making sales at retail in this state (and, therefore, subject to sales or use tax collection and payment) if:

1. the seller has a contract with a resident of Michigan
2. for direct or indirect "referrals" of potential customers
3. via a link on an internet website (or in-person, oral or other contact)
4. for a commission or other consideration
5. and the seller's gross receipts from all such referrals is greater than \$10,000.00 during the preceding 12 months.

Applying these tests to an internet posting with a "click through" link to the seller's website, the out-of-state seller would be required to collect and remit sales and use tax for all internet referrals where the website host is paid a commission for the referrals and the sellers gross receipts for all sales based on such referrals (in the aggregate) in the previous year exceed the \$10,000 threshold.

As we understand it, Google "adware" for a seller is placed pursuant to a contract with Google, which has a physical location in Michigan, wherein Google is paid a commission or other fee based on "click through" referrals from its website. Accordingly, if the aggregate amount of the seller's gross receipts from all sales originated by such click through referrals in the preceding 12 months exceeds \$10,000, then the seller would be "presumed" to be conducting retail sales in Michigan and would, therefore, be responsible for the collection and remittance of the sales or use tax to the State of Michigan.

The language of the bills is based on the substantially similar New York statute which has been interpreted by its Department of Taxation and Finance to not apply to purely passive "advertisements", i.e., the in-state contractor must engage in some affirmative solicitation of customers before the out-of-state seller is subject to taxation. Typically, the payment of a "commission", as opposed to a flat fee, is indicative of active conduct by the in-state contractor.

Accordingly, the bills provide a mechanism for out-of-state sellers to rebut the presumption by demonstrating that its in-state internet contractors did not engage in any solicitation or other activities within Michigan that is significantly associated with the seller's ability to establish or maintain a market in this state for the seller's sale of personal property to Michigan customers. If the seller rebuts the presumption, no tax is owed by the seller on such sales.

You have also asked how these new provisions will be enforced by the Michigan Department of Treasury against these out-of-state sellers.

In response to your question, we anticipate that the Michigan Department of Treasury will actively monitor websites of known internet referral companies and audit their records and those of the out-of-state sellers to determine if sales or use tax assessments are warranted. Other enforcement mechanisms may also be available to the Department through cross references to other tax reporting by the contractors and sellers and the application of industry averages.

Without the passage of these bills, however, the Department will not need to worry about enforcement since there would be no liability for the out-of-state sellers for such taxes. The purpose of the bills, of course, is for Michigan to capture those taxes directly from the out-of-state sellers as it currently does for Michigan main street retailers.

Please let me know if you have further questions or wish a more in-depth analysis of these issue.

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